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ABSTRACT

This unit on understanding the nature of small business, the first in a series of 18 modules, is on the second level of the revised PACE (Program for Acquiring Competence in Entrepreneurship) comprehensive curriculum. Geared to advanced secondary and beginning postsecondary or adult students, the modules provide an opportunity to learn about and try out entrepreneurship ideas so that students can make a preliminary assessment of how these ideas relate to personal needs. The units on this level contain detailed explanations of small business principles, suggestions on how to find information and use techniques, and encouragement for creating a future business. Students completing this unit should be able to perform these competencies: (1) describe the characteristics of a small business by type, (2) identify potential small business opportunities and determine ones they would select to follow, (3) describe the process of starting a small business, (5) discuss how competition affects small business, and (6) analyze what major factors will affect the success or failure of a selected type of business. The unit is organized into five sections. Following a preliminary section on how to use the unit (with vocabulary and a review of the objectives for this topic on level 1), the unit's information is presented in question-and-answer format. Individual and group activities, an assessment to be completed with the teacher, and sources used to develop the unit follow. A list of the modules of Revised PACE, Level 2 completes the unit. (KC)

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PACE
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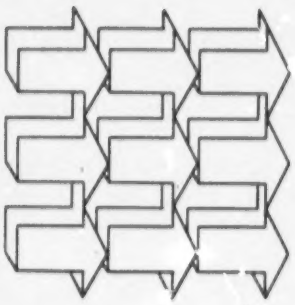

UNIT 1

☐ Level 1
☑ Level 2
☐ Level 3

# Understanding the Nature of Small Business

Developed by M. Catherine Ashmore and Sandra G. Pritz

**You will be able to:**

- **Describe the characteristics of a small business by type.**
- **Identify potential small business opportunities and determine one you would select to follow.**
- **Describe the process of starting a small business.**
- **Describe how supply and demand affect a small business.**
- **Discuss how competition affects small business.**
- **Analyze what major factors will affect the success or failure of a selected type of business.**

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## BEFORE YOU BEGIN. . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read the Unit Objectives on the front cover. If you think you can meet these objectives now, consult your instructor.

3. These objectives were met at Level 1:

   - Define a "small business"
   - Identify the different types of small businesses
   - Describe how small businesses contribute to the American way of life
   - Describe what role small businesses play in the American economic system
   - Identify the major factors contributing to the success of a small business

   If you feel unsure about any of these topics, ask your instructor for materials to review them.

4. Look for these business terms as you read this unit. If you need help with their meanings, turn to the Glossary in the *Resource Guide*.

   disclosure
   disposable income
   durable goods
   goods and services
   inflation
   recession

## UNDERSTANDING THE NATURE OF A SMALL BUSINESS

**WHAT IS THIS UNIT ABOUT?**

In his book *Entrepreneurship for the Eighties*, Gordon Baty says:

> Neither innovative genius, nor hard work, nor even luck is in itself a guarantee of corporate success. Assuming that all of these are present in the new venture in at least trace quantities, the missing catalytic element often seems to be what we might call the "entrepreneurial state of mind." It might be characterized as a degree of tough-mindedness that stops somewhere short of truculence; a confidence in one's intuitive as well as one's rational faculties; a capacity to think tactically on one's feet as well as to plan strategically in the business school sense; an attitude which stresses timely action based on frequently inadequate information, ahead of prolonged fact finding; and a mental set stressing integration of many facts into action plans, rather than endless differentiation and analysis. It is an attitude that says, in short: "I don't just come here to play the game - I CAME TO WIN."[1]

He also says, about the current "glut" of information about entrepreneurs:

> From the practical standpoint..... it does the entrepreneur very little good to know that his statistical chances of success are relatively poor if (a) he is a Gentile; (b) his father was not a businessman or self-employed professional; (c) he has a Ph.D.; and, (d) he is not 32.2 years of age.[2]

**WHAT BASIC INFORMATION ABOUT SMALL BUSINESS GIVES A BACKGROUND FOR THIS UNIT?**

If your goal for using this unit is to gain assistance in your own entrepreneurial activity, then the attitude that Mr. Baty describes is the one that will serve you well. This unit presents information to help you understand enough about small business to make a preliminary assessment of how it might meet your needs.

Small business is defined as the part of our economic system that is characterized by individual "enterprise" or the willingness to take some risk. A single small business is defined as one that is individually owned and operated and that is not a leader in its field of specialization.

The history of small business in America is the history of its founders, its inventors, and the rise of its great industrialists in the nineteenth century. It's the history of the human race's greatest strides towards creating equal opportunities for sharing wealth that was once only accessible to the rulers of the land.

Today's small businesses are the key to the variety of jobs and goods that characterize the four basic phases of the distribution system: wholesaling, services, retailing and manufacturing. Small businesses provide the environment and opportunity that encourage the formation of other small enterprises. In turn, these new enterprises are the creators of most of the new wealth in our economy. They offer every American the opportunity not only to "do it my way," but also

to achieve wealth equal to that of the greatest landowners and industrialists.

Small business thrives best when the potential for profit appears to be available as a result of each entrepreneur's own efforts. Natural regulation of the profit potential occurs through the laws of supply and demand. Supply and demand ultimately determine the levels of production and employment. Supply and demand also account for the birth and death of companies and even entire industries.

While many studies have been made on the reasons why businesses succeed and fail, the reasons for success usually boil down to a list of common sense elements. These elements include experienced and/or competent leadership (entrepreneurship); unique or strong products or services; and sufficient development capital. Planning ahead for the most effective use of these three components is also considered to be a reason for business success.

Successful entrepreneurs are usually tough-minded decision makers; hard working; self-confident; reasonable risk-takers; flexible; creative; goal setters; problem solvers; profit motivated; and enthusiastic.

**HOW MIGHT AN ENTREPRENEUR USE THE AVAILABLE SMALL BUSINESS STATISTICS?**

The facts and figures available on small business give some insight into historic performance trends of small businesses. Your use of such facts and figures, however, will determine their real value. If they are taken only as facts to be committed to memory, you may be able to pass any test, become a good speaker, or impress someone with your knowledge. If you use them as a true entrepreneur should—to generate ideas, to broaden your thinking (and thus your business potential), or to spot potential problems or solutions to problems—you will have accomplished more than any test can measure. You will have gained not only knowledge, but will also have experienced the "entrepreneurial state of mind." That is, you will be able to turn facts and figures into real business "action plans."

**ARE ADEQUATE DATA AVAILABLE?**

In its 1982 report to the Congress of the United States on the state of small business, the Small Business Administration (SBA) highlighted the inadequacy of the current data.

> The difficulties encountered in counting and/or defining the small business sector are due to the myriad data sources and multidimensional concepts that could be used to define business size categories. Detailed statistical information is collected on less than one-half of all businesses that file income tax returns with IRS.3

The SBA makes an important distinction between enterprises and establishments that is often missed by people who study small businesses. An *enterprise* is an individually owned and operated business. An *establishment* is a plant location at which business is conducted. Many establishments will be very different from those of an enterprise that is individually owned and operated.

To clarify the distinction between enterprises and establishments, the SBA is now working on a new computerized data base of information on small businesses in the United States. Soon the *Small Business Data Base* will be able to differentiate between enterprises and establishments through data on the "aggregate performance," (or overall level of economic activity) for each business in the United States. Such information will be very helpful in establishing accurate statistics on the country's businesses.

NOTE: The statistics in this unit are from the SBA unless otherwise noted.

**WHAT IS THE STANDARD INDUSTRIAL CLASSIFICATION (S.I.C.) CODE?**

To help classify businesses by type of activity, the U.S. Office of Management and Budget has developed the *Standard Industrial Classification* (SIC) code system. Whether the business is in agriculture or railroad transportation, or is on a national or international level, the system categorizes the entire range of business activities in our country. The major business categories are defined by two-digit numbers. For example, firms whose primary business is in wholesale trade/durable goods are classified under SIC code "50."

**WHAT AREAS OF BUSINESS WILL BE DISCUSSED?**

This unit covers the manufacturing SIC codes that begin at 20 and go through 39; the wholesale trade SIC codes 50 and 51; the retail trade SIC codes 52 through 59; and the service SIC codes that run from 70 through 89. Table 1 lists these codes and their definitions. The entire SIC code system from 01 through 99 is listed in the PACE *Resource Guide*. Although it isn't important to memorize the code numbers, you should know what types of businesses fall into each category.

In addition to knowing what major classification of trade a business is in, you will want to know what product it supplies, to whom it sells, the size according to the number of people it employs, sales volume, its capital resources, its facilities and equipment, and its method of operation.

## TABLE 1

## STANDARD INDUSTRIAL CLASSIFICATION CODE MANUFACTURING, WHOLESALE, RETAIL, SERVICES

### DIVISION D. MANUFACTURING

20. Food and kindred products
21. Tobacco manufacturers
22. Textile mill products
23. Apparel and other finished products made from fabrics and similar materials
24. Lumber, wood products (except furniture)
25. Furniture and fixtures
26. Paper and allied products
27. Printing, publishing, and allied industries

28. Chemicals and allied products
29. Petroleum refining and related industries
30. Rubber and miscellaneous plastics products
31. Leather and leather products
32. Stone, clay, glass, and concrete products
33. Primary metal industries
34. Fabricated metal products (except machinery and transportation equipment)
35. Machinery (except electrical)
36. Electrical and electronic machinery, equipment, and supplies
37. Transportation equipment
38. Measuring, analyzing, and controlling instruments; photographic, medical and optical goods; watches and clocks
39. Miscellaneous manufacturing industries

**DIVISION F. WHOLESALE**

50. Wholesale trade—durable goods
51. Wholesale trade—nondurable goods

**DIVISION G. RETAIL TRADE**

52. Building materials, hardware, garden supply, and mobile home dealers
53. General merchandise stores
54. Food stores
55. Automotive dealers and gasoline service stations
56. Apparel and accessory stores
57. Furniture, home furnishings, and equipment stores
58. Eating and drinking places
59. Miscellaneous retail

**DIVISION I. SERVICES**

70. Hotels, rooming houses, camps, and other lodging places.
72. Personal services
73. Business services
75. Automotive repairs, services, and garages
76. Miscellaneous repair services
78. Motion pictures
79. Amusement and recreation services (except motion pictures)
80. Health services
81. Legal services
82. Educational services
83. Social services
84. Museums, art galleries, and botanical and zoological gardens
86. Membership organizations
88. Private households
89. Miscellaneous services

SOURCE: U.S. Small Business Administration

**IN WHICH INDUSTRIES ARE MOST SMALL BUSINESSES FOUND?**

The pie chart in figure 1 gives an overview of the flow of the economy, beginning with the *production industries* of construction, manufacturing, and mining. Next are the *distribution industries* of transportation, communications, wholesaling, and retailing. The remainder of the economic flow is comprised of all of the service industries including financial institutions and farming.

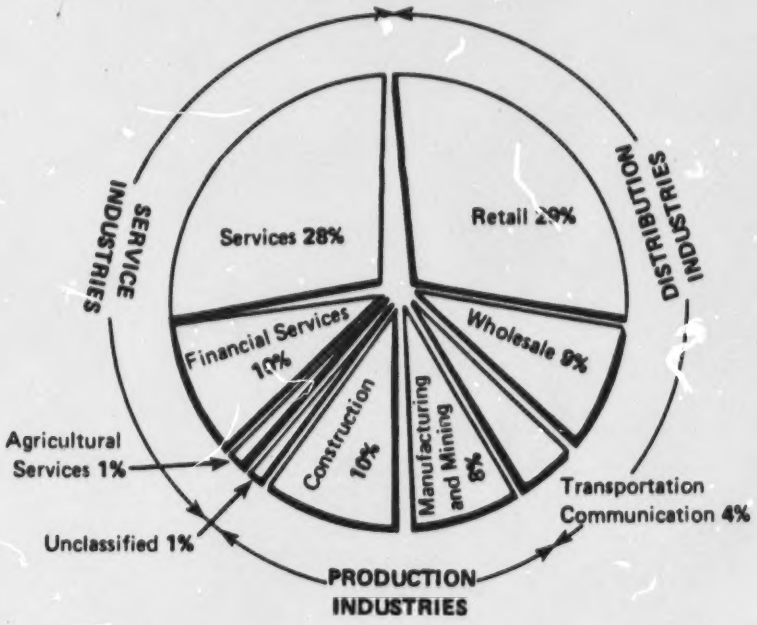


Figure 1. Small business by industry

SOURCE: Used with permission from the National Federation of Independent Business, Research and Education Foundation. San Mateo, CA: 1981.

Of the 14.7 million businesses in the United States, 10,000 of them are large companies with more than 500 employees. The remaining 99.8 percent are small businesses.

Small businesses employ 47 percent of the work force and produce 38 percent of our country's gross national product. But as you will see, the number of small businesses that are present in each industry varies greatly.

**WHAT ARE THE TRADITIONAL SMALL BUSINESS INDUSTRIES?**

Industries are classified "small business" or "large business" industries according to the average number of persons employed by a company in the industry and the amount of sales that are made. The traditional small business industries include wholesale trade, retail trade, agriculture, forestry, fishing, construction, and services. Manufacturing is not a typical small business industry. Manufacturing favors big business operations because of the high

start-up cost required (in equipment and facilities), the "economics of scale" (where mass production of large quantities of products offers a higher return on investment than would be possible with the limited production of products), and the higher operating costs for facilities, equipment, labor, raw materials, and energy. Manufacturing industries also have higher operating costs because of greater government regulations.

Table 2 illustrates the four basic industries to be examined—manufacturing, wholesaling, retailing, and service. It also shows the uneven distribution of sales and employment between large business industries and small business industries.

As each of the different industries is examined, a different topic will be analyzed. These topics are:

- Manufacturing—how to use statistics
- Wholesaling—how the "IDEA" process works
- Retailing—how the market place affects the business
- Service—how the entrepreneur affects the business

The intent is to provide you with as many different "idea generating" tactics as possible. Hopefully, you will be able to use these approaches in planning your own small business.

**ARE SMALL BUSINESS MANUFACTURING COMPANIES AS EFFICIENT AS BIGGER FIRMS?**

Of approximately 300,000 manufacturing firms in the U.S., nearly 95 percent of them are small firms. These small manufacturing businesses capture a low share of sales (21.7 percent) and a relatively higher share of employees (28.3 percent). Since the sales-to-employee ratio is not at a break-even point for the small business sector (one percent of the employees do not generate one percent of the sales), it is obvious that big manufacturing businesses get a bigger share of the sales for each employee.

**WHAT PRODUCTS ARE SMALL MANUFACTURERS LIKELY TO PRODUCE?**

The manufacturing SIC codes (table 1) define manufacturing businesses by the products they produce. Small manufacturing businesses tend to concentrate on products or areas like leather, apparel, and furniture where the cost of fixed assets (plant facilities and equipment) and operating expenses are lowest. Products or areas in which fixed assets and operating costs are high are dominated by big manufacturing businesses. These include petroleum, metals, paper, and chemicals. As you might suspect, the biggest profit potentials for manufacturing businesses are in areas that have high fixed asset costs.

TABLE 2

PERCENT OF TOTAL FIRMS, AND EMPLOYMENT AND SALES SHARES IN FOUR BASIC INDUSTRIES FOR FIRMS WITH LESS THAN 100 EMPLOYEES AND 500 EMPLOYEES

| Number of Employees | Wholesale | Retail | Services | Manufacturing |
|---|---|---|---|---|
| **Small Firms as a Percent of Total Numbers of Firms** | | | | |
| Less than 100 | 98.9 | 99.3 | 97.2 | 93.8 |
| Less than 500 | 99.9 | 99.9 | 99.4 | 98.6 |
| **Small Firms share as Percent of Total Employment** | | | | |
| Less than 100 | 68.5 | 56.8 | 32.0 | 16.1 |
| Less than 500 | 83.0 | 65.8 | 51.3 | 28.3 |
| **Small Firms share as Percent of Total Sales** | | | | |
| Less than 100 | 59.1 | 56.5 | 44.8 | 12.3 |
| Less than 500 | 74.5 | 65.5 | 62.1 | 21.7 |

SOURCE: Small Business Administration. *The State of Small Business: A Report of the President.* March 1982.

**DO SMALL BUSINESSES KEEP UP WITH BIG BUSINESSES IN PURCHASING THE BEST EQUIPMENT AND FACILITIES?**

One way to discover whether or not small businesses keep up with large businesses in purchasing the best equipment and facilities is to compare the total cost of equipment and facilities of a business to the total number of people it employs. In table 3, for example, notice that if the total cost of plant facilities and equipment is divided by the number of employees, big manufacturing businesses spend more money on these items than do small manufacturing businesses. A wage per employee comparison shows that the average salary is also higher in large manufacturing businesses than in small ones.4

**DOES MANUFACTURING HAVE A BUILT-IN HANDICAP FOR SMALL BUSINESS?**

It was mentioned that the high-profit segment of manufacturing are associated with high fixed asset costs. Therefore, it follows that if a company is big enough to invest in expensive plant facilities and equipment, it will be able to get into a high-profit segment. It can buy the best and most productive equipment.

With this equipment, the employees will be able to produce a bigger share of sales in the market. Therefore the company will earn more and have more capital to reinvest in bigger and better equipment. The big company can hire trained production employees away from smaller businesses who can't afford to pay higher salaries. With more experienced employees or bigger and better fixed assets, a big company can command an even larger share of the sales, and a recurring circle seems established.

TABLE 3

| Industry | Employees per Company | Fixed Assets (per production worker-1000) | Cost of Fixed Assets per Employee |
|---|---|---|---|
| Petroleum | 453 | $236.50 | .52 |
| Primary Metals | 261 | 63.10 | .24 |
| Paper | 199 | 63.50 | .32 |
| Chemicals | 160 | 108.10 | .68 |
| Leather | 151 | 4.60 | .03 |
| Apparel | 50 | 3.20 | .06 |
| Furniture | 26 | 9.40 | .36 |

SOURCE: Small Business Administration. *The State of Small Business: A Report of the President*. March 1982.

This line of reasoning is born out by the declining share of gross national product for small manufacturing businesses. In fact the small business share of manufacturing revenues is falling at a sharper rate than the industry itself is experiencing. So, while the industry declines, small business loses two ways. Not only does small business lose in the market decline, but it also loses to big business which claims a bigger share of the market. Thus, the statistics might imply that manufacturing has a built-in handicap for small businesses. It can be a handicap unless, as an entrepreneur, you (a) intend to stay small and make your profit in a small market niche and not by challenging big business on the economies of scale; (b) intend to operate a business as a trade school so you can sell "trained labor" as a product to big business; (c) have a better idea.

**HOW MIGHT A SMALL BUSINESS ENTREPRENEUR BEAT THE ODDS AND BE SUCCESSFUL IN A MANUFACTURING ENTERPRISE?**

If you are interested in opening a small manufacturing business you should—

- Determine which products or areas offer a reasonable chance for success. Do you think you can overcome some of the problems that small manufacturing businesses face? Is the potential worth the risk? In thinking about these questions, remember that successful entrepreneurs are "reasonable" risk-takers. They don't count on luck to see them through. They count on their own abilities and feel that they "make" their own luck.

- Get more information on the costs involved in opening a small manufacturing business. Think about the kind of employees you would need, the wages you would have to pay, and the costs for equipment, facilities, raw materials, and energy. Are there areas where your small business might have advantages over a large business? In considering this be sure to think about these possibilities.

- Can you locate in an area that is not suitable for a big manufacturing business?

- Are the building rental rates lower in your areas? Are there existing buildings that you could use?

- Is there an oversupply of labor in your area? Is there a chance that they would be willing to work for a lower wage than they might get in a big company? Can you offer them a more varied job? More training?

- Could you make some of your own equipment instead of buying it?

- Think about your potential customers. Are they really happy with the products they can buy from the big companies? Would many of the customers want products that are shaped, colored, shipped, or packaged differently? As a small manufacturer, you might have the flexibility to offer such custom-made products. Large manufacturers usually can't do this because they make their profits by producing large numbers of standardized products.

- Find out if another customer group could use the product. For example, assume that you manufacture heads for Phillips screwdrivers. Are there customers who buy a 1/4" steel drill bit from another manufacturer? Do they really need a 1/4" drill bit or do they need a 1/4" hole? Could the 1/4" Phillips screwdriver head that you manufacture double as a 1/4" drill?

- Determine whether or not your product or process could be cheaper, better, or faster than that of a large manufacturing company.

Tables 4 through 7 are just some of the statistics available from the SBA that can help with these questions. (Tables reprinted with permission from the Small Business Administration.)

Table 4 ranks the ten states with the largest number of employees per company and the ten states with the smallest number of employees per company. In the states with the largest companies, the economic climate might not be good for a small business in terms of competition. If you have chosen a business that provides services for a large company, however, or if you want to open a wholesaling operation, then one of the big business states might be a good location to consider.

**TABLE 4**

**RANK OF TEN STATES WITH THE LARGEST AND SMALLEST NUMBER OF EMPLOYEES PER COMPANY, 1978**

| Rank | State | Employees/Per Company |
|---|---|---|
| | **Largest Number** | |
| 1 | Delaware | 51.0 |
| 2 | Connecticut | 47.0 |
| 3 | New York | 41.0 |
| 4 | Michigan | 32.0 |
| 5 | Illinois | 30.3 |
| 6 | Ohio | 28.0 |
| 7 | Pennsylvania | 23.5 |
| 8 | Minnesota | 23.5 |
| 9 | Massachusetts | 21.9 |
| 10 | Missouri | 21.4 |
| | **Smallest Number** | |
| 1 | Colorado | 8.6 |
| 2 | Alaska | 8.8 |
| 3 | Wyoming | 9.7 |
| 4 | Vermont | 10.7 |
| 5 | North Dakota | 10.7 |
| 6 | South Dakota | 11.2 |
| 7 | New Mexico | 11.3 |
| 8 | Arkansas | 11.5 |
| 9 | Mississippi | 12.7 |
| 10 | Florida | 12.9 |

**SOURCE: Small Business Data Base tabulated by Brookings Institution from Dun and Bradstreet Market Identifier File.**

Table 5 lists the ten fastest and ten slowest employment growth areas by major industry group. Does your potential business fit one of these areas? Be careful if you have chosen a business in a slow growth area—you might soon find yourself fighting for survival.

**TABLE 5**

**TEN FASTEST AND SLOWEST EMPLOYMENT GROWTH AREAS FOR SMALL AND TOTAL ESTABLISHMENTS BY MAJOR INDUSTRY GROUPS, 1977-79**

| | Small Establishment Size Class[1] | | |
|---|---|---|---|
| | Fastest Growing (Descending Order) | | |
| Rank | Under 20 Employees | 20-99 Employees | Total Establishments |
| 1 | Educational Services | Educational Services | Educational Services |
| 2 | Social Services | Social Services | Social Services |
| 3 | Fisheries | Auto Repair Services | Misc. Services |
| 4 | Transportation Services | Special Trade Construction | Oil and Gas Extraction |
| 5 | Business Services | General Construction | Business Services |
| 6 | Misc. Services | Business Services | Fisheries |
| 7 | Auto Repair Services | Misc. Repair Services | Transportation Services |
| 8 | Oil and Gas Extraction | Legal Services | Special Trade Construction |
| 9 | Misc. Repair Services | Transportation Services | General Construction |
| 10 | General Construction | Pipeline Transportation | Misc. Repair Services |
| | | Slowest Growing (Descending Order)[2] | |
| 1 | Combined (Real Estate & Insurance) Offices | Combined (Real Estate & Insurance) Offices | Combined (Real Estate & Insurance) Offices |
| 2 | Petroleum Refining | Tobacco Manufacturing | Air Transportation |
| 3 | Food Processing | Text. Mill and Apparel | Metal Mining |
| 4 | Tobacco Production | Food Processing | Petroleum Refining |
| 5 | General Merch. Stores | Leather Products | Anthracite Mining |
| 6 | Primary Metal Industries | Commodity Brokers | Water Transportation |
| 7 | Motion Pictures | Anthracite Mining | Pipeline Transportation |
| 8 | Banking | Petroleum Refining | Leather Products |
| 9 | Leather Products | General Merch. Stores | Apparel & Fabricated Textiles |
| 10 | Metal Mining | Paper & Related Products | Misc. Manufacturing |

[1]Small establishments are defined as those with less than 100 employees.

[2]Descending order means that the fastest (slowest) growing industry is ranked first.

SOURCE: Department of Labor, Bureau of Labor Statistics, Unemployment Insurance (UI) System Data, unpublished size detail, January 1981.

Table 6 lists the ten fastest and ten slowest growth states in terms of their total number of small businesses. The healthy environments that are supporting strong small business growth may help you decide to pick a location in one of those areas.

On the other hand, if you are considering a small business that will do better if the competition isn't so intense, you may decide to pick a state where small businesses aren't growing. A decision like this should be thoroughly researched. Your chances for success are probably going to be better in areas of strong small business growth.

## TABLE 6

## TEN STATES OF FASTEST AND TEN STATES OF SLOWEST EMPLOYMENT GROWTH IN SMALL AND TOTAL ESTABLISHMENTS, 1977-79

| | Establishment Employment Size | | |
|---|---|---|---|
| | Small Establishment Size Class[1] | | |
| | Column 1: | Column 2: | Column 3: |
| Rank | Under 20 Employees | 20-99 | All Size Classes |
| | **Fastest-Growing States, 1977-1979 (Descending Order)** | | |
| 1 | Wyoming | Wyoming | Wyoming |
| 2 | Nevada | Arizona | Arizona |
| 3 | Florida | Nevada | Nevada |
| 4 | Arizona | Florida | Florida |
| 5 | California | Colorado | Oregon |
| 6 | Colorado | New Hampshire | Washington |
| 7 | Oregon | Oregon | Colorado |
| 8 | Washington | Washington | California |
| 9 | Mississippi | California | Texas |
| 10 | Idaho | Maine | Mississippi |
| | **Slowest-Growing States, 1977-1979 (Descending Order)[2]** | | |
| 1 | Iowa | Alaska | Alaska |
| 2 | Illinois | District of Columbia | West Virginia |
| 3 | New York | Illinois | Rhode Island |
| 4 | West Virginia | Hawaii | New York |
| 5 | Rhode Island | Iowa | Maine |
| 6 | South Dakota | New York | Delaware |
| 7 | Wisconsin | Nebraska | Nebraska |
| 8 | Ohio | Rhode Island | Iowa |
| 9 | Nebraska | Pennsylvania | Pennsylvania |
| 10 | Michigan | Wisconsin | Vermont |

[1]Small establishments are defined as those with less than 100 employees.

[2]Descending order means the fastest (slowest) growth state is ranked first.

SOURCE: Small Business Administration, Office of Advocacy, Small Business Data Base, based upon the Unemployment Insurance (UI) System, of the Department of Labor, Bureau of Labor Statistics, unpublished data.

Table 7 shows the most important small business problems for the years from 1977 to 1981. In 1981, the number one problem for small businesses was the interest rates for business capital. The number two problem was inflation. If these trends continue, you might decide not to buy expensive equipment of your own. Leasing equipment or sharing production time with another firm are good alternatives to consider.

Use the information in the tables to start thinking about your own small manufacturing business. Then write to associations. Read trade magazines. Talk to people from companies that are already operating. These sources can help you decide what kind of business to consider and what your chances of success might be. If you're not sure how to locate these sources, check your local library. It will probably have the trade publications and references lists you'll need.

Two good sources of manufacturing information are:

- *Enterprise*, a monthly publication by the National Association for Manufacturers. The Association's address is 1776 F Street N.W., Washington, D.C. 20006.
- *Industrial Engineering*, published by the Institute of Industrial Engineers. Write to the Institute in care of the Advertising Department, 25 Technology Park, Atlanta, Georgia 30092.

Other resources are listed in the PACE *Resource Guide*.

**WHAT ARE THE TYPES OF SMALL BUSINESSES IN THE WHOLESALE INDUSTRY?**

If you're considering a manufacturing career, keep this thought in mind. One of the best ways to identify business opportunities is to talk to potential customers. Remember—your ultimate success will depend on their needs and your ability to serve those needs.

Wholesale businesses can be grouped into three major types based on operating characteristics:

- merchant wholesalers
- manufacturer's sales branches
- merchandise agents and brokers

Here is how *Jobber Topics*, a monthly magazine that goes to all automotive wholesalers, describes a merchant wholesale operation.

> Jobbers (merchant wholesalers) buy primarily from warehouse distributers and manufacturers. They stock parts, equipment, and supplies and sell them to gasoline service stations, general repair shops, vehicle dealers, and specialty repair shops serving specific markets such as heavy duty equipment, high performance equipment, and auto body, farm, and industrial equipment.[5]

## TABLE 7

## SINGLE MOST IMPORTANT SMALL BUSINESS PROBLEM, 1974-1981

| Most Important Problem | 1974 | | | | 1975 | | | | 1976 | | | | 1977 | | | | 1978 | | | | 1979 | | | | 1980 | | | | 1981 | | | |
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| | Jan | | July | | Jan | | July | | Jan | | July | | Jan | | July | | Jan | | July | | Jan | | July | | Jan | | July | | Jan | | July | |
| | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % | Rank | % |
| Taxes | 3 | 10 | 3 | 10 | 3 | 11 | 2 | 19 | 2 | 17 | 2 | 22 | 2 | 21 | 2 | 19 | 2 | 22 | 2 | 21 | 2 | 15 | 2 | 18 | 3 | 15 | 2 | 18 | 3 | 16 | 3 | 15 |
| Inflation | 2 | 23 | 1 | 36 | 1 | 37 | 1 | 27 | 1 | 28 | 1 | 25 | 1 | 24 | 1 | 27 | 1 | 25 | 1 | 33 | 1 | 36 | 1 | 39 | 1 | 35 | 1 | 33 | 1 | 32 | 2 | 26 |
| Inadequate Demand for Protection | 9 | 2 | 9 | 1 | 9 | 1 | 6 | 6 | 8 | 5 | 8 | 3 | 8 | 4 | 7 | 5 | 8 | 3 | 8 | 2 | 8 | 2 | 9 | 2 | 8 | 3 | 5 | 7 | 4 | 5 | 6 | 8 |
| Interest Rates Financing | 9 | 8 | 2 | 12 | 2 | 13 | 4 | 8 | 5 | 8 | 5 | 7 | 7 | 5 | 8 | 4 | 7 | 5 | 5 | 7 | 3 | 11 | 3 | 9 | 2 | 18 | 3 | 15 | 2 | 25 | 1 | 31 |
| Min. Wage Labor Cost | 8 | 3 | 8 | 4 | 7 | 4 | 8 | 5 | 6 | 6 | 6 | 6 | 5 | 7 | 5 | 8 | 4 | 8 | 5 | 7 | 5 | 7 | 6 | 5 | 7 | 4 | 8 | 3 | 7 | 4 | 9 | 3 |
| Other Govt. Reg./Red Tape | 5 | 8 | 5 | 8 | 4 | 9 | 3 | 12 | 3 | 13 | 3 | 14 | 3 | 12 | 3 | 12 | 3 | 12 | 3 | 10 | 4 | 9 | 3 | 9 | 4 | 9 | 4 | 8 | 4 | 5 | 5 | 8 |
| Competition from Large Business | 5 | 8 | 5 | 8 | 5 | 8 | 4 | 8 | 4 | 10 | 4 | 9 | 4 | 10 | 4 | 9 | 4 | 8 | 7 | 8 | 5 | 7 | 6 | 5 | 5 | 5 | 6 | 5 | 4 | 5 | 5 | 5 |
| Quality of Labor | 3 | 10 | 5 | 8 | 6 | 5 | 6 | 6 | 6 | 6 | 7 | 5 | 6 | 6 | 6 | 7 | 6 | 7 | 4 | 9 | 5 | 7 | 5 | 6 | 5 | 5 | 8 | 5 | 8 | 3 | 8 | 4 |
| Shortage of Fuel, Goods or Material | 1 | 23 | 4 | 9 | 7 | 4 | 9 | 2 | 9 | 1 | 9 | 1 | 9 | 2 | 9 | 1 | 9 | 1 | 9 | 1 | 9 | 1 | 6 | 5 | 8 | 3 | 9 | 1 | 9 | 1 | * | * |
| Other No Answer | – | 5 | – | 4 | – | 8 | – | 7 | – | 8 | – | 8 | – | 9 | – | 8 | – | 8 | – | 5 | – | 5 | – | 5 | – | 5 | – | 5 | – | 4 | 4 | 8 |
| Total | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | | 100% | |

SOURCE: Quarterly Economic Report for Small Business, National Federation of Independent Business, various editions.

*Less than 1 percent.

Manufacturer's sales branches are normally owned by large firms and sell only the products of the owner or "parent" firm.

Merchandise agents typically sell the products of a few select companies. They do not provide warehouse facilities.

**WHAT ARE THE SALES AND EMPLOYEE CHARACTERISTICS OF SMALL BUSINESSES IN WHOLESALING?**

As you can see in table 2 of this unit, small wholesaling businesses employ a large number of people (83 percent of all small business employment) and are responsible for a large amount of sales (75 percent of all small business sales). Note, however, that big businesses are able to garner a 25 percent share of the sales with only 17 percent of the employees in that field. The average annual wage of employees in big and small businesses in wholesaling is almost the same. This indicates that small business is able to compete for skilled labor in that industry.

Many beginning entrepreneurs seem to think that wholesaling is a confusing business because of the complex relationship between the wholesaler and manufacturers or retailers. Although this may be true in some cases, it is also true that a wholesaling business is often a safer risk than manufacturing or retailing businesses.

Wholesalers don't have to take the risk of manufacturing products that might not sell. They don't have to take the risk of stocking a lot of products that might not sell because their customers are a relatively small group of other people or businesses. This makes the job of anticipating supply and demand much easier. The financial rewards for wholesalers can also be bigger since the wholesalers' initial investment are usually low, and orders are usually big.

**SHOULD AN ENTREPRENEUR CONSIDER GOING INTO THE WHOLESALE TRADE?**

Starting a wholesaling business is much the same as a manufacturing business. Here are some of the planning factors you should consider.

- Examine overall industry statistics for wholesaling. Analyze your risks and opportunities in terms of products, location, size of operation, product mix, and method of operation. Check with the SBA for information.

- Examine the "industry profiles" of potential customers. Find out what they buy, when they buy, how many potential customers there are, and what their needs are. You'll find the answers to many of these questions in surveys conducted by the U.S. Census Bureau. The surveys are usually available at your local library. You'll also want to check for information from trade associations and in industry publications.

- Try to think about some of the other ways customers could use your product. The best way to do this is to increase your own knowledge of the industry. Make contact with people in industry. Talk with manufacturers and customers. Attend trade shows and association meetings. Read trade publications. This will help you build a practical foundation for your creative ideas.

- Analyze the product or service for unique characteristics that meet an unfulfilled need. Customers are the ultimate source for identifying the needs that a product might fulfill. Industry trade magazines often have reader research that can help in defining and analyzing the product from the user's viewpoint. Association meetings and trade shows offer great opportunities to explore this question with many different people in a short period of time.

The National Association of Wholesaler-Distributers publishes a monthly newsletter as well as legal and legislative bulletins and books on wholesaling. The Association's address is 1725 K Street N.W., Washington, D.C. 20006.

**WHAT ARE THE CHARACTERISTICS OF SMALL BUSINESS IN THE RETAIL AREA?**

Almost one-third of all small business enterprises are retail stores. Review table 2 in this unit. Notice that as an industry, retailing small businesses (like wholesaling) employ a large share of all employees (65.8 percent). Retailing also captures a large part of the total sales (65.5 percent). Unlike wholesaling, however, the share of sales per employee is about even. One percent of the employees is equal to one percent of the sales. Thus the efficiency of a small retailing operation seems to be equal to the efficiency of a big operation.

In terms of the number of individual business establishments, retailing is the most widely scattered sector of the entire distribution system. That is, retailing firms with 1,000 or more employees have approximately 150 to 200 establishments per 1,000 employees. (Big manufacturing and wholesaling companies only have 1/3 to 1/2 that many establishments.) The great number of small retailers probably helped create the market demand for convenient shopping locations—and thus forced the larger companies to open more stores in order to stay competitive.

**DO WAGES PAID TO RETAIL EMPLOYEES PLAY A SIGNIFICANT PART IN THE ABILITY OF SMALL BUSINESSES TO COMPETE?**

The 1977 average annual wage for an employee in a retail company with more than 500 employees was $7,798. An employee of a smaller retail firm averaged $6,990. (These figures have not been adjusted for the high use of part-time labor in small retail operations.) Since the ratio of sales to employees is about even, it seems that the experience and skill levels of employees in big retail operations is comparable to those of employees in small operations. Small retail businesses do not appear to be at a wage disadvantage in attracting competent help.

**WHAT TYPES OF SMALL RETAIL BUSINESSES ARE EXPERIENCING THE GREATEST FAILURE RATES?**

Retail trade, along with services, is a growing segment of the economy. Even so, retail business failures are also on the increase (see table 8). As you can see from the table, companies that sell lumber, building materials, and hardware experienced the highest rate of failure (73 percent). Eating and drinking places have had the lowest failure rate (41 percent).

TABLE 8

INCREASE IN MONTHLY BUSINESS FAILURES, FIRST QUARTER 1980 TO FIRST QUARTER 1981

| | Percent |
|---|---|
| Retail Trade | 46 |
| Food and Liquor | 54 |
| Apparel Accessories | 48 |
| Lumber, Building Materials and Hardware | 73 |
| Automobile Group | 53 |
| Eating and Drinking Places | 42 |

SOURCE: Dun and Bradstreet, *Monthly Business Failures.*

Defining business failure is the subject of great debate. A business may dissolve for a variety of reasons. These include mergers, retirement of the owner, failure with no loss to a creditor, or failure with a loss to a creditor. Most business dissolutions are failures with no loss to a creditor.

There is also disagreement on whether or not it's economically healthy to have business failures. Nicholas Siropolis and other economic experts agree that some small business failures are the healthy result of a free enterprise system where entrepreneurs can learn best through mistakes.[6] Even if this is true, you should plan carefully for a retailing career in light of the current failure rate.

**WHY MIGHT SOME RETAIL BUSINESSES BE FAILING AT FASTER THAN NORMAL RATES?**

A recessionary economy hurts a small business much more than it does a big business. This is basically due to the fact that small businesses have smaller margins of profit or "profit cushions" to see them through hard economic times. Statistics also show that a new firm with fewer than twenty employees only has a 37 percent chance of surviving for four years. Risks that are common across the entire retailing industry undoubtedly account for some of these failure statistics. A lot of the failures, however, are probably caused by small businesses that failed to meet changing market demands.

As a practical exercise, think about why the failure rate for lumber, building materials, and hardware stores is so high. Besides "outside" forces such as a building industry slump and the pressures of recession and inflation, other reasons that these businesses failed might be (1) that many of the "mom-and-pop" hardware stores stayed in central city locations while shoppers moved out to the suburbs; (2) that many of the stores didn't develop successful profit formulas for selling to a combined market of consumers and contractors; and (3) that many stores didn't offer any advantages in products, services, or prices.

If you're thinking about starting your own retail store, the best way to meet those risks is to have a solid knowledge of the customer's needs before you open the business. You should also have a plan for answering those needs before they become problems.

**WHAT ARE THE CHARACTERISTICS OF A SMALL BUSINESS IN THE SERVICE AREA?**

The service industry includes such varied businesses as hotels, motion pictures, health care, legal and educational assistance, social services, and auto repair. Review table 2 on page 9 again. Like retailing and wholesaling, the service industry is characterized by the fact that small service businesses have a large share of employees (51 percent) and sales (62 percent) than do large service businesses.

**WHAT CHARACTERISTICS OF THE MARKETPLACE MAKE SERVICE A NATURAL CHOICE FOR SMALL BUSINESSES?**

A small business in the service area is an exception, however, to the usual profile of a typical small business operation. That is, small service businesses have a disproportionately high share of the total service industry sales when compared to its share of employees. This is probably due to the very nature of the service industry. The primary market areas for service businesses are those that answer a number of personal needs. For example, motion picture theaters must appeal to customers' moral, ethical, social, and entertainment needs as well as more general needs such as price, location, and comfort. Thus you can see that service market areas are often restricted in size.

The smaller the scale of activity or the smaller the market area that a business has, the more tailored and profitable it can be. In general, people are willing to pay more if they have a dress or suit exactly tailored to their needs than if they buy something that is ready-made. If you open a small service business, remember that getting this higher price will be critical to your business success because the number of customers you will serve will be small. Thus one of the factors to consider in selecting a market area for a small service business is whether or not the "per unit" price of the service can be high enough to give the business a reasonable profit level.

**WHAT TYPES OF SERVICE BUSINESSES ARE GROWING FASTEST?**

As was noted before, small service companies in the legal, medical, leisure, and business areas are getting the biggest share of sales. Review table 5. As you can see, the ranking of the ten fastest and ten slowest employment growth areas for small business show that these are in the top ten growth areas.

**WHY IS THE SERVICE INDUSTRY EXPECTED TO PRODUCE THE MOST GROWTH IN THE EIGHTIES?**

Throughout the 1980s, service is predicted to be the largest area for small business growth. The good news for would-be entrepreneurs is that you can start a small service business with almost any kind of capital investment. You might start with a bucket and mop, an X-ray machine, or even a mummy. Thus it should be easy for you to find a service area that meets both your interests and your risk-taking abilities.

As Americans begin to value time more than money, the demand for time saving services will increase in direct proportion to their amount of "disposable" or extra income. When people start buying these time saving services, there will be additional needs for services in areas such as food service, amusement, education, and travel.

**ARE WOMEN AND MINORITIES PARTICIPATING IN OWNERSHIP OF SMALL SERVICE BUSINESSES?**

The service industry is particularly characterized by the number of minorities and women who own their own service businesses. Of the 518,000 businesses owned by minorities, 234,000 (45 percent) are service businesses. Of the 662,000 businesses owned by women, 316,000 (48 percent) are service businesses. (See table 9.)

TABLE 9

FIRMS OWNED BY MINORITIES AND WOMEN AS A PERCENTAGE OF U.S. FIRMS BY SELECTED INDUSTRY DIVISION, 1977

| Industry Division | Total | Minority-Owned Number | Percent | Women-Owned Number | Percent |
|---|---|---|---|---|---|
| Industry Total | 9,440[1] | 518[2] | 5.5 | 662[2] | 7.0 |
| Construction | 1,107 | 53 | 4.7 | 21 | 1.9 |
| Manufacturing | 287 | 13 | 4.2 | 19 | 6.6 |
| Transportation, Communication, and Utilities | 419 | 37 | 8.6 | 12 | 2.9 |
| Wholesale and Retail | 2,600 | 156 | 6.0 | 228 | 8.8 |
| Finance, Real Estate and Insurance | 1,404 | 28 | 2.0 | 66 | 4.7 |
| Selected Services | 3,623 | 234 | 6.5 | 316 | 8.7 |

[1]Includes only sole proprietorships, partnerships, and small (Subchapter S) business corporations.

[2]Does not include miscellaneous categories of business termed "unallocated" or "other."

SOURCE: Small Business Administration. *The State of Small Business: A Report of the President*. March 1982.

Try to analyze why the proportion of businesses owned by minorities and women is so high in the service industry. Some of the reasons might be—

- the relative ease of getting into and managing a service business;
- the variety in needed start-up capital;
- fewer government regulations.

The reasons these factors probably appeal to women and minorities is the historically unequal treatment of both groups and their unequal access to the educational system that provides resources and knowledge of business management methods.

Another reason for the high concentration of minorities and women in service businesses might be their abilities to better identify significant customer segments that are not already being served.

The success of a service business is highly dependent on the entrepreneur's ability to identify with the marketplace; to define specific needs; to isolate significant group needs; and to offer acceptable solutions to those needs.

**WHAT AREAS OF THE SERVICE INDUSTRY REPORTED INCREASED BUSINESS FAILURE RATES IN 1981?**

Reported areas of retail trade experienced an average forty-six percent increase in business failures from 1980 to 1981 (table 9 of this unit). Reported service industry businesses averaged sixty-eight percent more failures in 1981 (see table 10). That's the highest failure increase of all reported major industry segments. Within the service segment, repair service companies reported an eighty-eight percent increase. Miscellaneous personal service business failures increased sixty percent. Business service companies failures increased fifty-three percent. Since service firms tend to be very small, (95 percent employ fewer than ten employees), many undoubtedly failed as a result of the economy and their financial inability to absorb the effects of the recession and high interest rates.

**TABLE 10**

**INCREASE IN BUSINESS FAILURES BY SELECTED MAJOR INDUSTRY GROUPS, FIRST QUARTER 1980 TO FIRST QUARTER 1981**

| | Percent |
|---|---|
| Commercial Services | 68 |
| Miscellaneous Personal Services | 60 |
| Business Services | 53 |
| Repair Services | 88 |

SOURCE: Dun and Bradstreet, *Monthly Business Failures.*

**WHAT IS THE SINGLE BIGGEST CAUSE OF ANY SMALL BUSINESS FAILURE?**

No matter what area your business is in—manufacturing, wholesaling, retailing, or service—there's always a chance of failure. Remember that some of the reasons for failure (such as a sluggish economy, recession, or high interest rates) are "external" reasons that you can plan for but can't always control. If you look at some of the "internal" reasons for failure, however, there are some factors you can directly control. A review of industry studies shows that the number one cause of business failure is mismanagement by the entrepreneur.

If you wanted to analyze why a repair service business might fail because of mismanagement, you might think about the time, competence, and record keeping needed to repair common household items. For example, when is the last time you were able to get a repair made on an appliance at home? How long did the repair shop keep your television, or radio, or automobile? What kind of detailed invoice did you receive? How organized were the records and schedules when you called to find out when something was ready? Did you have to wait for parts to be delivered from somewhere else? Did you find it difficult to get in touch with the owner? Did you vow never to go back to that company again?

Small business entrepreneurs who fail have generally planned for their own defeat simply because they didn't plan for their success. The successful small business entrepreneur not only identifies customers' needs, but also maintains customer satisfaction. In thinking about what your own small business enterprise might be, determine what kind of management the business needs to maintain customer satisfaction. Decide whether or not you can or want to provide it.

**HOW CAN YOU FIND SMALL BUSINESS OPPORTUNITIES FOR YOURSELF?**

Small business opportunities are not hard to find. If you don't already have an idea for your own small business, you can buy or rent one ready-made. Some companies specialize in selling business ideas, and magazines exist to keep entrepreneurs informed of all the latest opportunities. Some big businesses sell the new product ideas that their own research and development people developed.

One source for the names and addresses of such "idea companies" is the yellow pages of the phone book. Check under "inventors," patent attorneys," business brokers," business consultants," and "business and trade organizations." Another source is the local newspaper. Business opportunities are often listed in the classified section.

Some other sources you might check are—

- *Entrepreneur*: a monthly publication by the International Entrepreneur's Association, 631 Wilshire Boulevard, Santa Monica, California 90401. The subscription rate is $35.00 per year.
- *Income Opportunities*: a monthly publication by Davis Publications, Inc., 380 Lexington Avenue, New York, New York 10017. The subscription rate is $10.00 per year.
- *Venture*: The Magazine for Entrepreneurs is a monthly publication by New Venture Magazine, Inc., 35 West 45th Street, New York, New York 10036. The subscription rate is $12.00 per year.
- *DAX Money-Maker Confidential Newsletter* is a monthly publication by DuVall Press Financial Publications, 920 West Grand River, Williamston, Michigan 48895. The subscription rate is $45.00 per year.
- The *Small Business Reporter* is published by the Bank of America, P.O. Box 37000, San Francisco, California 94137. The subscription rate is $10.00 for ten issues. A free Publication Index that lists all topics currently available is published annually. A complete set of business operation discussions is available for $15.00, and a complete set of business profiles is available for $35.00.

**DOES BUYING A LICENSE OR BUYING SOMEONE ELSE'S IDEA REDUCE THE NEED FOR MANAGEMENT BY THE ENTREPRENEUR?**

Before buying any outside business ideas or services, you should personally review them to see if you want or need the type of service offered. Before employing a service to find an idea, or before buying

the manufacturing rights to a product or idea, remember that the hard part of the entrepreneurial task will be to make it work for *you*. It should become so integrated into your thinking that you intellectually and emotionally "own" the idea. You should shape it so that it fits your management style. You should refine it to fit your operational expertise and preference. You should define it to meet the labor and capital resources available to you. And remember—you will have to do all of this under any licensing or copyright restrictions of the seller.

Karl Vesper's book *New Venture Strategies* is an excellent source of ideas that can help you activate your own creative thought processes. Vesper details case histories of successful entrepreneurs, and describes the environment and experiences that led to their business ideas. His bibliography also offers a wealth of additional reading sources. Many of the entries in the bibliography can be found in the PACE *Resource Guide*.

**HOW CAN YOU ACTIVATE OR IMPROVE THE ENTREPRENEURIAL SKILL OF DEVELOPING NEW BUSINESS IDEAS?**

In working to develop your own ideas, the most important step is to simply practice identifying and analyzing ideas wherever or whenever they occur.

Undoubtedly, most people have had a good idea (or the start of one) that could have been the basis for a business venture. Good ideas often occur when you are physically busy with routine tasks—while mowing the lawn, raking the grass, stuffing envelopes, driving the car or erasing a chalk board. The ideas may be directly connected with what you're doing, or they may come from your subconscious mind. But rather than waiting for ideas to pop up, there is a way to call them up as you need them.

One of the most well-known advocates of the "positive mental attitude" way to success is Og Mandino, author of *A Treasury of Success Unlimited*. Here are his ideas on putting the subconscious mind to work successfully:

> (Your subsconscious) . . . functions slowly or swiftly on commands which you give it by your conscious mind, dependent exactly on how deeply you really mean it! You've heard people say, "I set my heart on this or that - and I got it!"
>
> Start living in the consciousness of what you want. Clothe it with your desires; see it happening in your mind's eye. Have faith it is going to happen; put forth every effort to help make it happen; and keep the "mental ether" magnetically charged with the mental pictures of your objective.
>
> Do this, and step by step you will draw to you what you need (in the form of conditions, resources, and people).[6]

**IS THERE AN ENTREPRENEURIAL "STATE OF MIND?"**

This is the entrepreneurial "state of mind." It is the source of the self-confidence and optimism described as entrepreneurial traits by most observers.

**HOW DO YOU DECIDE IF THE IDEA IS WORTH ANY MORE TIME AND EFFORT?**

One of the simplest methods of deciding which idea or ideas are worth further exploration is to make a list of personal advantages and disadvantages for each item. Then evaluate the strengths and weaknesses of the business venture itself.

The list of personal advantages and disadvantages would include such items as these under the advantages—

- I like doing this kind of work.
- I already know a lot about it.
- My family would like me to try it.
- My spouse and I could (or couldn't) work together in the business.
- I would become rich and famous.
- I would be respected just for doing my job.
- I would be my own boss.
- I could work at my own pace.
- I could develop my own method of doing business.
- My friend Linda and I could go into business together.
- I would be helping others.
- I would be meeting my personal goals.

The list of business strengths and weaknesses of the idea would include such items as these under strengths—

- The idea is legal.
- The product fills a sizable market need.
- The profit potential is high.
- The potential for quick profits exists.
- The potential for long-term profits exists.
- The intial investment is low.
- The idea is ethical.
- I can get the investment or operating money I need.
- I can personally manage the business.
- The location is available.
- The raw materials I'll need are available.
- The help I'll need is available.

You can get as sophisticated and complex in this evaluation process as you want. One way would be to assign a value to each of the elements on your list, depending on their importance to you and to the business. Use the total score as the basis for a "go/no go" decision. Another way would be to decide which items you would rule out. Can you afford it? Do you want to take the risk? Would you do it if you didn't like the kind of work it involved? Then, prioritize the others. Get help on any you aren't sure of (market need, location and so on). Finally, make the typical entrepreneurial decision based on less than 100 percent chance of success. Just try to be sure you have a reasonable chance of being right.

As Gordon Baty points out—

> The personal and professional risks of a new enterprise are rather less than might be imagined. To be sure, you may be giving up a $25,000 job for a $10,000 job for a few quarters; you

may miss some vacations and some professional meetings. Yet, assuming the worst, you lose your savings and go back to a $25,000 job having become a broader and more valuable person than you were when you left. None of this is to say that the process is risk-free; nothing worth doing ever is. It merely says that the downside risks are not only not unthinkable, but may be a lot less than you'd imagined.[7]

**WHAT IS THE PROCESS FOR STARTING A NEW BUSINESS?**

Starting your own small business can occur as an unexpected result of some activities you are performing right now. For example, many child care centers begin informally when a person with a great reputation for babysitting ends up with more children than can fit in the living room on a rainy day. Many business consultants drift into a pattern of "consulting" because they work on corporate ideas and management for their own company. Great restaurants and commercial food products have been started by good cooks whose friends asked them to "bring the baked beans—you know, your special recipe." Other businesses develop haphazardly as a reaction to specific customer demands.

**WHAT ARE THE SPECIAL PROBLEMS OF SMALL BUSINESSES THAT START UP HAPHAZARADLY?**

While the "haphazard" method may be an easy way to get a business started, it can present special problems for the entrepreneur. Many times this method of operation is established on a personal level with friends and acquaintances. When the entrepreneur tries to change them, the original customers resist and resent the innovations. In a company with informal beginnings, the tendency might be for the entrepreneur to overlook basic considerations in legal or financial areas. The entrepreneur could underestimate the impact of a full-time business on personal life style, or overestimate the total market demand.

This method of starting a business calls for the entrepreneur to be sensitive to opportunities for enlarging the customer base. At the same time, though, the entrepreneur should be sensitive to satisfying the original group of customers. They will probably provide the "bread-and-butter" of the business for a while. The entrepreneur should be ready to "shift gears" if it becomes apparent that many people want something a little different than the original product. The haphazard start-up also requires sensitivity to unexpected family disruptions.

Although the successful entrepreneur who starts a venture in this manner may not have written a formal plan of operation, the goals and operating plans for the endeavor are set and shifted continuously as the business progresses and problems are solved.

**WHAT STEPS WOULD YOU TAKE TO FORMALLY START A NEW BUSINESS?**

If you want to plan a small business in a more formal manner, the process is really fairly simple.

Nicholas Siropolis says planning requires entrepreneurs to *anticipate*—

- the potential market for their venture
- the potential costs of meeting the demands of that market

- the potential pitfalls in organizing the operations of the venture
- the early signals they will use to alert them of progress or setbacks.[8]

The units of the complete PACE series are the outline for a new business start-up procedure. The PACE curriculum is designed specifically to help you produce a personal, workable business plan that anticipates risk. The steps of the process are to—

- understand the nature of a small business;
- pick an area you think offers the best opportunity for your success;
- understand your own strengths and weaknesses as a would-be entrepreneur in this area;
- develop the business plan;
- obtain the technical assistance necessary to supplement any areas of expertise you or your partners don't have;
- choose the type of ownership which fits the operation;
- plan your marketing strategy;
- decide on a location for the business;
- decide how you will finance the business;
- determine how you will deal with any legal issues;
- determine how you will comply with the government regulations that affect your business;
- decide how you will manage the business;
- decide how you will manage the employees;
- decide how to promote the business;
- decide how to manage the sales efforts;
- decide how you will maintain effective business records;
- decide how you will manage the finances;
- determine the customer credit and collection policies;
- decide what insurance will be needed.

**WHAT CAUSES SUPPLY AND DEMAND LEVELS TO VARY?**

Supply and demand determine production and employment levels for every industry. The competition between companies acts as a control on the availability, quality, and price of goods in demand.

If you look at how supply and demand might work in the wholesaling industry, you can see that the nature of the market demand determines the nature of the competition between companies.

For example, when plastic pipe was first introduced to American industrial plants, the demand for quality was high. Industrial use of plastic pipe was untried and unproven. Companies who established a reputation for quality performance did not have to compete with every other supplier for the business. Most plant managers bought plastic pipe only from "safe", experienced suppliers.

But as time passed, industrial plant operators decided that as long as the pipe was guaranteed to meet certain performance standards, they could safely buy from any supplier. Then came the battle of price competition. It drove the price so low that the profit margin didn't leave the suppliers much room for competitive bidding. Everyone was bidding at rock-bottom prices.

It is at this stage of competition that the product becomes classified as a "commodity." That is, while it is a necessity, the quality, quantity, and price are no longer a source of active concern for the buyers.

When this occurs, the engineers and plant managers no longer get involved in purchase decisions. The plant purchasing agent buys from a master "spec" list of approved suppliers The purchasing agent can go to a catalog or business directory of suppliers, and select a product. The choice may be based on delivery time, volume discounts, familiarity with the sales representative, or other variables. Often, the variables are not directly connected with the purchase of the particular item. Some company purchasing agents use many different suppliers just to keep all of them on their toes. Others believe in using a few good suppliers who will be helpful during product shortages, shipping delays, or other unusual conditions. Competition at this level is more complex, but the knowledgeable entrepreneur learns to predict supply and demand very accurately.

**HOW DO CAPITALISM AND COMPETITION AFFECT SMALL BUSINESS?**

Milton Friedman is an "expert's expert" on economics, a spokesman and defender of the free enterprise system; a teacher; and an author. In his book, There's No Such Thing as a Free Lunch, he recounts an interview on the state of the American economic system. One exchange between Friedman and the interviewer is:

Interviewer: Critics of capitalism feel that too many alternatives can cause waste, that we don't need forty-seven models of Chevrolets when on would do.

Friedman: If consumers really preferred one model at a lower price than forty-seven models, G.M. would be foolish not to meet their desires. There are forty-seven models because that is what consumers want. That's what the critics really complain about—that under capitalism, consumers get what they want rather than what the critics think they should have. It's always amused me that the intellectuals who talk loudest about waste of competition in business are the loudest defenders of the waste of competition in the intellectual world.

Isn't it absolutely wasteful that millions of writers should be deciding what to write on their own—a hundred writers may be writing on the same subject—with no social priorities being imposed on what subjects they write about? Isn't it deplorable that thousands of scientists should each be picking their own subjects for investigation? Shouldn't there be a central planning board that decides which subjects have the highest social priority and assign those subjects to the researchers most suited to pursue them, to see that there is no duplication?

Suggest this to any of the intellectuals who whine about the waste of competition in the business world and almost all of them will be horrified. Most of them would recognize that it would be terrible because the essence of the intellectual world is that it's a search for the unknown, an attempt to find new things by a process of trial and

error in which you have a great deal of duplication. For every nine people who go off on a bum lead, one person's going to go on a right lead. The same thing is true in the business world.

Interviewer: What about the criticism that capitalism leads to material extravagance and aesthetic starvation?

Friedman: The historical fact is precisely the reverse. The greatest opportunity for the expression of nonmaterial motives is in free enterprise societies. The great triumphs of literature, art, architecture, and science have all been the products of individuals. Are the great examples of architecture the state buildings of Russia or some of the homes Frank Lloyd Wright designed for private people? Did Thomas Alva Edison produce his inventions for a central planning board under a Five-Year Plan or did he produce them under a system of individual incentives?[9]

**WHAT ARE THE MAJOR FACTORS THAT AFFECT THE SUCCESS OR FAILURE OF A SMALL BUSINESS?**

The major factors that affect the success and failure of small businesses are both internal and external. Misjudging any one of them could mean failure. However, if the entrepreneur is competent, all the other problems can probably be solved successfully.

These factors have been discussed throughout this unit—

- Competence of the entrepreneur
- Viability of the product or service in the marketplace
- Availability of capital
- Management of the business
- Proper goal setting and planning

These factors again point out that the "entrepreneurial state of mind" must pervade every phase of the operation. While it is still unclear what specific characteristics are needed in successful entrepreneurs, it is very clear that unique state of mind exists.

## ACTIVITIES

Do you feel that you understand something about the nature of small business? The following activities will help you to put that understanding to use.

**INDIVIDUAL ACTIVITY** List the ways you think the characteristics of an independent enterprise would be significantly different from an establishment that is a branch operation of a big business.

**INDIVIDUAL ACTIVITY** Not everyone agrees that construction is a "production" industry. Where else do you think it might fit within the production/distribution system?

**INDIVIDUAL ACTIVITY** Review the various areas of manufacturing in the SIC codes 20 through 39. (See Table 1.) Pick one in which you might choose to open a small business. List the general industry trends you'd want to consider before starting such a business. List the kinds of actions you might take to be able to be successful in spite of negative industry trends.

**INDIVIDUAL ACTIVITY** Develop a short "contingency" (or emergency) plan to increase sales for the manufacturing area you chose in the previous activity. Are there other possible markets for your product? That is, besides filling typical consumer needs (flexibility strength, and so on), are there other possible benefits to the customer (safety, economy, and so on)?

**INDIVIDUAL ACTIVITY** Write to two trade associations for some general information on manufacturing or for specific information on one of the SIC manufacturing areas. When it arrives, prepare a report on (1) the general history of manufacturing or (2) on the current state of a specific manufacturing industry. Try to include some information on specific products or services within the industry.

**INDIVIDUAL ACTIVITY** Four and six-digit SIC codes are available to help you learn more about specific manufacturing industries. Check with either your state Department of Economic Development or a local library for a copy of these codes. Also write to the nearest Small Business Administration office for the information they have on manufacturing. When you have collected enough data, prepare a report on what you have learned and how it might help an entrepreneur better understand the opportunities in manufacturing.

**INDIVIDUAL ACTIVITY** How helpful were each of the resources you obtained in the last activity? Did they refer you to additional information resources? Begin building a name and address file of sources and resources. By doing this, you can obtain valuable information as well as industry contacts.

**INDIVIDUAL ACTIVITY** From the information you have, what conclusions can you draw about the relationship between small wholesale businesses and large wholesale businesses? List the questions you need to consider before starting your own wholesaling business.

**INDIVIDUAL ACTIVITY** If you're interested in the automotive business opportunities represented in *Jobber Topics* magazine, write to them for additional information on their industry. You'll find the address for this organization in the PACE *Resource Guide*.

**INDIVIDUAL ACTIVITY** Write to the National Association for Career and Business Opportunity for information. (You will find the address in the PACE *Resource Guide*.) Select an area of wholesaling that you are interested in. From the information you get, tell why this area might represent a good small business opportunity.

**INDIVIDUAL ACTIVITY** Check the yellow pages of your phone directory under "Wholesalers" and "Associations." If there are any listings, write or call to find out if any information is available. Call or write the nearest SBA office for information on small business opportunities in the wholesaling area. After gathering the information, write a report about any specific and helpful information you've found. Be sure to add any names and addresses to your contact file.

**INDIVIDUAL ACTIVITY** After you have selected a segment of the wholesaling industry, check your local library for a copy of the The *Business Publications Rates and Data*. This publication lists all trade magazines by the specific field they serve. Select several magazines. Read each magazine's audience description to determine whether or not the wholesalers in that industry are receiving that particular publication. Write to one or two of the magazines and ask for basic market information. Write a report on any new information you find. Does this new information change your mind about the industry area you're interested in? Why?

**INDIVIDUAL ACTIVITY** Visit a local shopping mall that has at least one major chain store. Count the number of small, independent stores that sell the same kinds of items. Select two of the smaller stores that you think have become good competitors. Select stores that have made the most of unique and innovative displays, choice of product, service, or quality/price policies. Write a short description of your observations on each store's business strategies. This will help you plan good marketing strategies for your own small business.

**INDIVIDUAL ACTIVITY** Visit a small store and talk to the owner. Find out how different industry-wide problems are affecting the business. Find out how the owner is dealing with these problems. Ask the owner what kind of customers the store attracts. Are they old, young, affluent, educated, single, and so on? Write a report on what you've learned. Determine some other steps you might take if you were the owner. List your ideas as opportunities to explore in your own small business.

**INDIVIDUAL ACTIVITY** GET THE PERMISSION OF THE STORE OWNER TO DO THIS ACTIVITY. Talk to some of the store's customers. Observe them and describe some of their buying characteristics. Ask them what they

like about shopping in the store. Find out what they came to the store to buy. Find out if there's anything they would add or change in the store. Write a brief report on your findings. Compare your findings with the information from the store owner. Evaluate how closely the owner assessed his or her customer's feelings about the store. Did you uncover any new customer needs? Offer to share the results with the owner.

**INDIVIDUAL ACTIVITY** Now that you know something about the marketing aspects of a small retail business, reevaluate your decision on the area of retailing you chose to enter. Have you changed your mind? Write a report on why or why not. Tell what the interviews changed or confirmed in your thinking about small retail business.

**INDIVIDUAL ACTIVITY** Compare the different types of service business in the SIC codes 70 through 89. (See table 1 of this unit.) Select the one you think might be a good area for a small business. Write a brief profile of the company you would start and the customers you would serve. List why you chose this area of business based on your current knowledge of the area.

**INDIVIDUAL ACTIVITY** The next time you're watching a ballgame, cleaning the house, watching the kids, or playing softball, consider what business ideas you could be generating. Take a sheet of paper and list all the things you see, do, don't see, and don't do that you think you might turn into a business idea. At this stage, no idea is too wacky. What you are doing is making a "shopping list" of ideas that you can use later to determine areas that offer practical potential and opportunity. One of the hardest parts of this activity (especially for practical, logical businesspeople) is to overcome the urge to discard the idea because—

- it won't work
- it's been tried before
- it's too crazy
- if it's such a good idea, someone would have done it earlier
- it's such a simple idea, it probably won't work
- it'll cost too much
- it can't be produced
- people won't accept it because it's never been done this was before

**INDIVIDUAL ACTIVITY** Look around your study area. What do or don't you have that would make studying easier? Educational services are one of the fastest growing industries in the country. List any ideas you think would improve your own study area. Would other people appreciate the same things? Would they be willing to pay for it? Compare your list with other people in your class.

**ASSESSMENT**

Directions: Read the following assessment questions to check your own knowledge of the information in this unit. When you feel prepared, ask your instructor to assess your competency on them.

1. How can statistics help you make an informed decision?
2. What is the difference between an establishment and an enterprise?
3. What is the Standard Industrial Classification code?
4. What are the traditional small business industries?
5. What products are small manufacturing firms likely to produce?
6. If you were going to open a small manufacturing business, what are some of the questions you would need answers to before starting the business?
7. How might the Small Business Administration be helpful in answering the questions?
8. Where else besides the Small Business Administration might you go for help in answering the questions?
9. What role do wholesalers play in bringing goods to the marketplace?
10. What are three basic types of wholesalers?
11. Why might wholesaling be difficult for a first-time entrepreneur?
12. Is retailing traditionally an area for small business endeavors? Why or why not?
13. What might be some of the causes for failure in a small retail business?
14. What are some typical service industry businesses?
15. Why does the marketplace affect service businesses so critically?
16. Why does the marketplace affect service businesses so critically?
17. Why is the service industry expected to grow in the 1980's?
18. What is the single biggest cause of business failure?
19. How can we find opportunities for becoming small business entrepreneurs?

20. Can we develop entrepreneurial skills?

21. How might you decide if your "idea" for a small business invention or new combination of old products and services is worthwile pursuing?

22. What are some ways that new businesses get started?

23. How do supply and demand affect the economy?

24. How does competition affect supply and demand?

25. What are the major factors that affect the success or failure of a small business?

**NOTES**

[1]Baty, Gordon B. *Entrepreneurship for the Eighties.* Reston VA: Reston Publishing Co., 1981, p. xi.

[2]Ibid., p. 4.

[3]U.S. Small Business Administration, *The State of Small Business: A Report to the President.* Washington, DC: U.S. Government Printing Office. 1982, p. 60.

[4]Ibid, p. 191.

[5]*Business Publications Rates and Data.* Skokie, IL: Standard Rate and Data Service. March, 1982.

[6]Mandino, Og. *A Treasury of Success Unlimited.* With a Special Introduction by W. Clement Stone. New York: Combined Registry Co. Copyright under International and Pan-American Copyright Conventions. 1966, p. 51.

[7]Baty, p. 6.

[8]Siropolis, Nicholas. *Small Business Management—A Guide to Entrepreneurship.* Second Edition. Boston: Houghton Mifflin Co. 1982, p. 136.

[9]Friedman, Milton. *There's No Such Thing as a Free Lunch.* La Salle, IL: Thomas Horton and Co., 1975, pp. 32-33.

We thank the above authors for permission to reprint from their work.

**OTHER SOURCES USED TO DEVELOP THIS UNIT**

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Timmons, Jeffrey A., Smollen, Leonard E., Dingee, Jr., Alexander, L. *New Venture Creation.* Homewood, IL: Richard D. Irwin, 1977.

Wasserman, Paul, Managing Editor; Georgi, Charlotte, Associate Editor; Woy, James, Associate Editor. Encyclopedia of Business Information Sources. Detroit: Paul Wasserman. Gale Research Company. 1980.

For further information, consult the lists of additional sources in the *Resource Guide.*

Level 2

# PACE

Unit 1. Understanding the Nature of Small Business

Unit 2. Determining Your Potential as an Entrepreneur

Unit 3. Developing the Business Plan

Unit 4. Obtaining Technical Assistance

Unit 5. Choosing the Type of Ownership

Unit 6. Planning the Marketing Strategy

Unit 7. Locating the Business

Unit 8. Financing the Business

Unit 9. Dealing with Legal Issues

Unit 10. Complying with Government Regulations

Unit 11. Managing the Business

Unit 12. Managing Human Resources

Unit 13. Promoting the Business

Unit 14. Managing Sales Efforts

Unit 15. Keeping the Business Records

Unit 16. Managing the Finances

Unit 17. Managing Customer Credit and Collections

Unit 18. Protecting the Business

Resource Guide

Instructors' Guide

Units on the above entrepreneurship topics are available at the following three levels:

- Level 1 helps you understand the creation and operation of a business
- Level 2 prepares you to plan for a business in your future
- Level 3 guides you in starting and managing your own business

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